Report

of the

Examination of

Progressive Northern Insurance Company

Mayfield Village, Ohio

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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January 20, 2004

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Commissioner of Insurance
State of Wisconsin
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Honorable John W. Oxendine
Secretary, Southeastern Zone, NAIC
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Honorable John Morrison
Secretary, Western Zone, NAIC
Commissioner of Insurance
State of Montana
840 Helena Avenue
Helena, Montana 59601

Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

PROGRESSIVE NORTHERN INSURANCE COMPANY
MAYFIELD VILLAGE, OHIO

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1998, as of December 31, 1997. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Actuarial Review by the Ohio Insurance Department

Since its inception, the company has been a participant in a comprehensive reinsurance pooling agreement with Progressive Casualty Insurance Company and certain of its property and casualty affiliates. In consequence, the company's net loss and loss adjustment expense reserves are the product of the reserves of the Progressive insurance companies' reinsurance pool and the company's participation percentage in the pool.

An actuary on the staff of the Ohio Department of Insurance reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves, as a function of its participation in the pool. The results of her work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuary's conclusion.

II. HISTORY AND PLAN OF OPERATION

Progressive Northern Insurance Company (hereinafter also “PNIC” or “the company”), a stock property and casualty company operating under ch. 611, Wis. Stat., was incorporated in the state of Wisconsin on August 19, 1980, and commenced business on March 8, 1981. From inception, The Progressive Corporation has been the parent and sole shareholder of the company.

As of December 31, 2002, the company’s capitalization included $3,008,000 in the form of 128 common shares (of 300 authorized) with a par value of $23,500 per share, and $210,592,000 of paid-in and contributed surplus. The following schedule reflects the activity in capital stock and paid-in surplus since the incorporation of the company:

Year	Authorized Common Shares	Issued and Outstanding	Par Value Per Share	Capital Paid Up	Gross Paid-In and Contributed Surplus
1980	100	100	$15,000	$1,500,000	$ 1,000,000
1982					300,000
1984					600,000
1985					1,700,000
1986			23,500	850,000	(850,000)
1987					5,000,000
1993	200	28		658,000	(158,000)
1994					6,000,000
1995					2,000,000
1996					25,000,000
1997					98,000,000
1999					32,000,000
2002					40,000,000
12/31/2002	300	128	$23,500	$3,008,000	$210,592,000

PNIC has some employees. All operations are conducted by employees of Progressive Casualty Insurance Company and other Progressive subsidiaries in accordance with their business practices and internal controls. Virtually all expenses are initially paid by Progressive Casualty Insurance Company. Expenses other than taxes are then allocated on the basis of specific identification, utilization estimates developed from such criteria as premium or claim volume, and time studies, in accordance with the Progressive reinsurance pooling agreement. Tax allocations are established in accordance with a written federal income tax allocation agreement. Intercompany balances with affiliates are created in the ordinary course of business, with settlements made on a quarterly basis. Written agreements with affiliates are further described in the section of this report titled "Affiliated Companies."

The company conducts its operations jointly with its affiliates from Progressive Casualty Insurance Company's home office in Mayfield Village, Ohio. Additional support services are provided by the Progressive Casualty Insurance Company's personnel in a network of call centers and claim administration offices in 350 locations throughout the United States and Canada.

In 2002, the company wrote business in 30 of the 38 jurisdictions in which it is licensed. The distribution of direct premiums written in 2002 by state or other jurisdiction was as follows:

Pennsylvania	$ 359,122,507	27.2%
Connecticut	134,051,485	10.2%
Wisconsin	108,288,925	8.2%
Minnesota	97,071,533	7.4%
Kentucky	67,601,765	5.1%
New York	65,234,285	4.9%
New Hampshire	57,971,796	4.4%
Indiana	55,001,073	4.2%
Nebraska	54,178,440	4.1%
Rhode Island	54,173,779	4.1%
All Other U.S.	265,224,403	20.1%
Total	$1,317,919,991	100.0%

As of the examination date, the company was licensed in the District of Columbia and the following 37 states:

Alaska	Maine	Oklahoma
Arizona	Maryland	Oregon
Colorado	Minnesota	Pennsylvania
Connecticut	Mississippi	Rhode Island
Delaware	Montana	South Carolina
Georgia	Nebraska	South Dakota
Hawaii	Nevada	Utah
Idaho	New Hampshire	Vermont
Indiana	New Mexico	Virginia
Iowa	New York	Washington
Kansas	North Carolina	West Virginia
Kentucky	Ohio	Wisconsin
Louisiana		

The U.S. Treasury Department approved PNIC as an admitted reinsurer for surety business on August 30, 1999. The company is licensed to conduct business in Texas on a surplus lines basis.

In the state of Wisconsin, the company is licensed to transact the following lines of business as defined by s. Ins 6.75 (2), Wis. Adm. Code:

(a) Fire, Inland Marine, and Other Property
(c) Disability
(d) Liability and Incidental Medical Expense
(e) Automobile and Aircraft
(f) Fidelity
(g) Surety
(j) Credit Insurance
(n) Miscellaneous

Direct premiums written in 1997 and 2002, by line of business, were as follows:

Line of Business	1997 Direct Premium	1997 Percent	2002 Direct Premium	2002 Percent	Percent Change in Premium
Private passenger auto liability	$319,962,649	62.5%	$730,707,686	55.4%	128.4%
Commercial auto liability	20,222,923	3.9%	111,651,526	8.5%	452.1%
Auto physical damage	166,697,725	32.5%	453,878,022	34.4%	172.3%
Other liability - occurrence	1,072,266	0.2%	6,189,822	0.5%	477.3%
Inland marine	2,153,612	0.4%	9,641,754	0.7%	347.7%
Homeowner's multiple peril	2,169,755	0.4%	5,851,180	0.4%	169.7%
Gap addendum	29,700	0.0%	0	0.0%	(100.0)%
Total All Lines	$512,308,630	100.0%	$1,317,919,990	100.0%	157.3%

The following table is a summary of the net insurance premiums written by the company in 1997 and 2002:

Line of Business	1997 Net Premium	1997 Percent	2002 Net Premium	2002 Percent	Percent Change in Premium
Private passenger auto liability	$345,885,037	60.6%	$561,566,632	53.4%	62.4%
Auto physical damage	188,307,033	33.0%	389,882,074	37.1%	107.0%
Commercial auto liability	26,662,882	4.7%	82,636,376	7.9%	209.9%
Inland marine	4,285,629	0.8%	8,630,908	0.8%	101.4%
Other liability - occurrence	1,815,676	0.3%	4,198,620	0.4%	131.2%
Homeowners multiple peril	1,346,274	0.2%	2,417,563	0.2%	79.6%
Other liability—claims made	1,414,719	0.2%	1,320,136	0.1%	(6.7)%
Fidelity	698,844	0.1%	722,807	0.1%	3.4%
Surety	38,844	0.0%	34,022	0.0%	(12.4)%
Gap addendum	76,571	0.0%	33,410	0.0%	(56.4)%
Earthquake	0	0.0%	87	0.0%	N/A
Allied Lines	10,126	0.0%	0	0.0%	(100.0)%
Workers compensation	3,349	0.0%	0	0.0%	(100.0)%:
Total All Lines	$570,544,984	100.0%	$1,051,442,635	100.0%	84.3%

The growth of the company is discussed in the Financial Data section of this report.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of nine members. All directors are elected annually to serve a one-year term. The directors receive no compensation for their service on the board. All directors are employees of other Progressive companies. Members of the board may also be members of other boards of directors in the holding company system controlled by The Progressive Corporation.

Name and Residence	Principal Occupation	Term Expires
Glenn M. Renwick Chagrin Falls, Ohio	Chief Executive Officer	2004
W. Thomas Forrester II Moreland Hills, Ohio	Chief Financial Officer	2004
William H. Graves Austin, Texas	Director of Agency Market	2004
Charles E. Jarrett Pepper Pike, Ohio	Chief Legal Officer	2004
Thomas A. King South Russell, Ohio	Treasurer	2004
Brian J. Passell Hudson, Ohio	Claims Group President	2004
Gregory J. Trapp St. Louis, Missouri	Agency General Manager	2004
Richard H. Watts Ocala, Florida	Sales & Service Group President	2004
Robert T. Williams, Jr. Aurora, Ohio	Agency Group President	2004

Officers of the Company

The officers serving at the time of this examination are listed below. These officers are also officers for other companies in the Progressive group. The compensation shown is the total compensation for the officers in the group.

Name	Office	2002 Compensation
Glenn M Renwick	Chairman of the Board and President	$1,851,986
Dane A Shrallow	Secretary and Vice President	587,651
Thomas A King	Treasurer	701,236
Kathy M Cerny	Assistant Secretary	46,473
James L Kusmer	Assistant Treasurer and Vice President	166,702
Jeffrey W Basch	Vice President	249,087
W Thomas Forrester II	Vice President	436,872
Charles E Jarrett	Vice President	547,665
Timothy F Kaselonis	Assistant Vice President	101,945
Timothy F Cercelle	Assistant Vice President	107,301

The salary amount allocated to Northern is calculated by dividing Northern's net premium written by the total net premium written for the Progressive group. Northern's 2002 rate was 11.1198001%.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees as of December 12, 2003 are listed below:

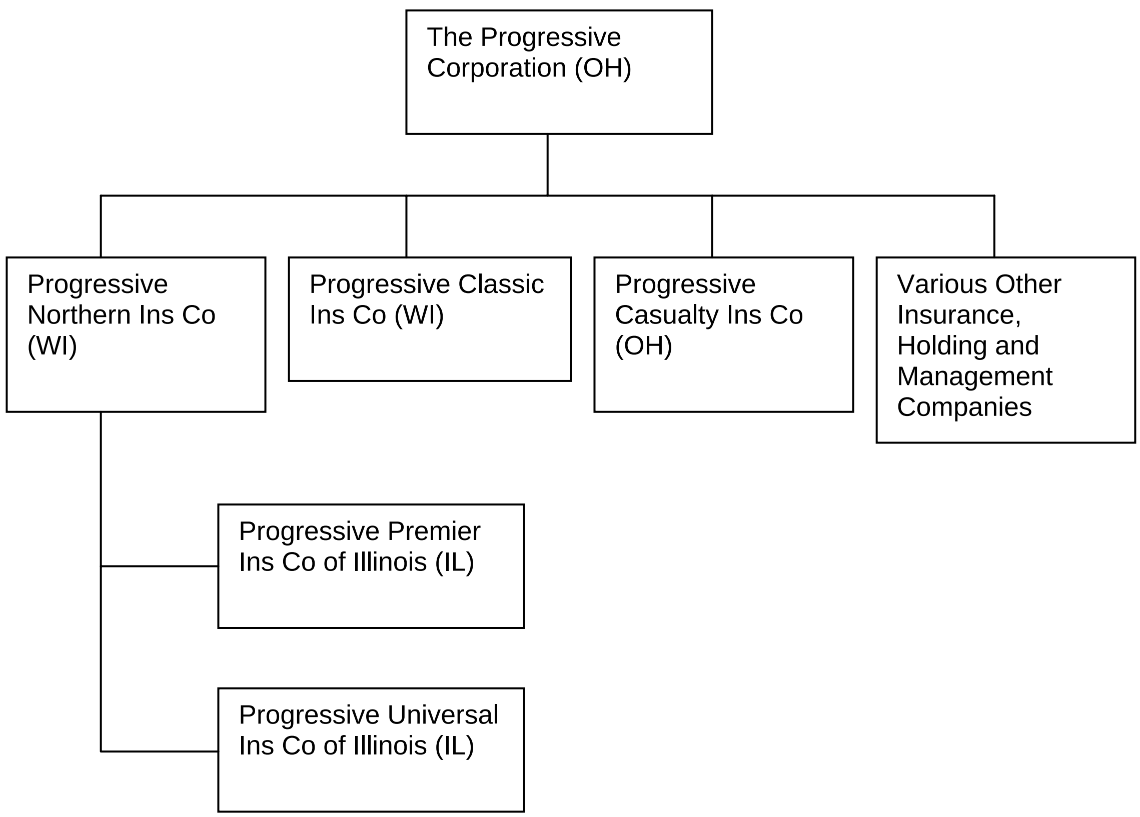
Executive Committee
Glenn M. Renwick, Chairman
W. Thomas Forrester, II, Member
Thomas A. King, Member
Charles E. Jarrett, Alternate Member

Investment Committee
Glenn M. Renwick, Chairman
W. Thomas Forrester, II, Member
Charles E. Jarrett, Member
Thomas A. King, Alternate Member

IV. AFFILIATED COMPANIES

Progressive Northern Insurance Company is a member of a holding company system (hereinafter also, "Progressive Insurance Companies") under the control of The Progressive Corporation. As of December 31, 2002, The Progressive Corporation had 70 subsidiaries, one mutual insurance company affiliate and one reciprocal insurance company affiliate. Due to the number of The Progressive Corporation's subsidiaries and other interests, this report will confine its narrative of specific entities within the holding company system to PNIC's parents and subsidiaries. A brief description of the significant affiliates of PNIC follows the organizational chart.

Organizational Chart
As of December 31, 2002



Effective August 29, 2003, PNIC transferred ownership of Progressive Premier Insurance Company of Illinois and Progressive Universal Insurance Company of Illinois to The Progressive Corporation through a dividend.

Effective January 1, 2004, The Progressive Corporation created two intermediate holding company subsidiaries, Progressive Agency Holdings, Incorporated and Progressive Direct Holdings, Incorporated and contributed each of its various insurance subsidiaries to one of the holding companies. Ownership of PNIC was contributed to Progressive Agency Holdings, Incorporated. The Subsequent Events section of this report contains additional comment on this change.

The Progressive Corporation

The Progressive Corporation is an Ohio-domiciled insurance holding company formed in 1965. The predecessor organization commenced business in 1937. The Progressive Corporation became publicly traded after an initial public offering in 1971, and its common stock is currently listed on the New York Stock Exchange. The corporation's management estimated that, based upon consolidated premium volume, it is the fifth largest private passenger automobile insurance organization in the United States. On a consolidated GAAP basis for the year ending December 31, 2002, The Progressive Corporation reported assets of $13,564,400,000, liabilities of $9,796,400,000, shareholders' equity of $3,768,000,000, and a net income of $667,300,000.

Progressive Casualty Insurance Company (PCIC)

PCIC, a property casualty insurer domiciled in Ohio, provides administrative services through affiliated agreements discussed below. As of December 31, 2002, the company's audited financial statement reported assets of $6,092,398,526, liabilities of $4,472,960,217, and policyholders' surplus of $1,619,438,309. Operations for 2002 produced net income of $246,127,572.

Progressive Classic Insurance Company (Classic)

Classic, a property casualty insurer domiciled in Wisconsin, is an affiliate of PNIC. As of December 31, 2002, the company's audited financial statement reported assets of $322,029,918, liabilities of $231,963,872, and policyholders' surplus of $90,066,046. Operations for 2002 produced net income of $20,028,976.

Progressive Premier Insurance Company of Illinois (Premier)

Premier, a wholly owned subsidiary of PNIC, is an insurance company domiciled in Illinois that writes primarily nonstandard automobile coverage, in Illinois only, through independent agents. As of December 31, 2002, the company's audited financial statement reported assets of $19,578,952, liabilities of $8,863,963, and policyholders' surplus of $10,714,989. Operations for 2002 produced net income of $1,086,280.

Progressive Universal Insurance Company of Illinois (Universal)

Universal, a wholly owned subsidiary of PNIC, is an insurance company domiciled in Illinois that writes private passenger automobile coverage solely in Illinois. As of December 31, 2002, the company's audited financial statement reported assets of $11,442,234, liabilities of $5,882,736, and policyholders' surplus of $5,559,498. Operations for 2002 produced net income of $281,497.

Affiliated Agreements

In addition to common staffing and management control, various written agreements affect PNIC's relationship to its affiliates. The pooling agreement is described in the reinsurance section of the report. A brief summary of the other agreements follows:

1. Type: Consolidated Tax Allocation Agreement

   Parties: PNIC along with other members of the Progressive holding company system

   Effective: January 3, 1983

   Terms: The agreement establishes that at year-end a consolidated tax liability will be computed for The Progressive Corporation, with each member company's recoverable or payable equal to the amount that the member company would have reported on a nonconsolidated basis. Settlements are to be made within ninety (90) days of the end of The Progressive Corporation's fiscal year.

2. Type: Cash Management Agreement

   Parties: PNIC, Progressive Casualty Insurance Company (Casualty) and other Progressive affiliates

   Effective: January 1, 1998

   Terms: All cash receipts or disbursements attributable to PNIC and the other affiliates named in the agreement are deposited in or withdrawn from a centralized account (Cashier Account) that is managed by Casualty. Pursuant to the terms of the agreement, PNIC has a balance with this account that reflects its claim against or obligation to the Cashier Account. Casualty provides the company with monthly statements that shows the month-end balances. Account balances are considered loans and interest is payable or receivable to the company's account depending on the balance. The provisions of an Interest Agreement to which PNIC is a party govern the rate of interest. Each participant to the agreement receives a quarter-end balance that represents a net amount against any other intercompany transaction. Settlements are to be in cash or readily marketable securities valued at market value.

3. Type: Interest Agreement

Parties: PNIC, Progressive Casualty Insurance Company (Casualty) and other Progressive affiliates

Effective: The Company became a party to this agreement on October 15, 1980, retroactive to January 1, 1980. The original effective date of the agreement was January 1, 1977.

Terms: This agreement establishes the variable interest rate that governs each entity's participation in Casualty's Cashier Account as noted in the Cash Management Agreement in #2 above. Interest is to be computed at the prevailing 90-day U.S. Treasury bill rate on the last day of each month rounded to the nearest quarter of a percent.

4. Type: Investment Services Agreement

Parties: PNIC along with other participating affiliates and Progressive Capital Management Corporation (Progressive Capital). Progressive Capital was formerly known as PPLP Corporation, then Progressive Partners, Inc., until it changed its name to that currently used on June 8, 1998.

Effective: July 16, 1992, as subsequently amended

Terms: Progressive Capital provides investment management services to members of the Progressive holding company system named in the agreement. The agreement requires each of the participating companies to reimburse Progressive Capital for an equitable portion of the costs and expenses it incurs in providing its services. Progressive Capital does not charge any additional management fees to the participating companies.

5. Type: Premium Financing Agreement

Parties: PNIC along with other affiliates that have executed this agreement and Progressive Premium Budget, Inc. (PPB).

Effective: January 1, 1981

Terms: Pursuant to the terms of the agreement, PPB agrees to offer its premium financing facilities to insureds of the contracting companies. PPB receives interest and fees paid by the insureds.

6. Type: Interest and Commission Agreement

Parties: PNIC and other affiliates of Casualty and Progressive Premium Budget, Inc.

Effective: The Company became a party to this agreement on January 26, 1983, retroactive to January 1, 1982. The original effective date of this agreement was as of January 1, 1971.

Terms: This agreement establishes the interest rate on account balances between PNIC and Progressive Premium Budget, Inc., a premium financing company. Per an addendum to the agreement that became effective as of January 1, 1982, the applicable interest rate is one point over the prime rate as determined by National City Bank of Cleveland.

7. Type: General Agency Agreement (Participation terminated December 27, 2003)

Parties: PNIC along with other participating affiliates and United Financial Insurance Agency, Inc. and United Financial Insurance Agency of Washington, Inc. (the United Financial Agencies)

Effective: May 15, 1996

Terms: The United Financial Agencies have authority to solicit, provide quotes, receive applications, bind coverage, collect and receive premiums on behalf of PNIC. In exchange, PNIC will pay commission to the United Financial Agencies based on its applicable commission schedules in effect as of the inception date of each policy or renewal affected by the United Financial Agencies.

V. REINSURANCE

PNIC cedes 100% of its direct business above minor underlying coverages to the Progressive reinsurance pool under an agreement effective January 1, 1988, and last amended as of January 1, 1997. PNIC then receives a 12% retrocession from the Progressive pool. The Progressive reinsurance pooling agreement contained proper insolvency provisions. The members of the Progressive pool, with their respective pool percentages are shown below.

Participation	
Progressive Casualty Insurance Company	53%
Progressive Northern Insurance Company	12
Progressive Northwestern Insurance Company	12
Progressive Specialty Insurance Company	7
Progressive Preferred Insurance Company	6
Progressive Classic Insurance Company	3
Progressive American Insurance Company	2
Progressive Gulf Insurance Company	2
Progressive Bayside Insurance Company	1
Progressive Mountain Insurance Company	1
Progressive Southeastern Insurance Company	1
Total	100%

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Progressive Northern Insurance Company
Assets
As of December 31, 2002

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$748,823,270		$748,823,270
Stocks:			
Preferred stocks	19,039,140		19,039,140
Common stocks	140,482,715		140,482,715
Real estate:			
Occupied by the company	126,026		126,026
Cash	114,219		114,219
Short-term investments	448,502		448,502
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	22,388,940	6,283,674	16,105,266
Premiums, agents' balances, and installments booked but deferred and not yet due	226,132,995		226,132,995
Reinsurance recoverable on loss and loss adjustment expense payments	264,310		264,310
Federal and foreign income tax recoverable and interest thereon	63,685,018	15,348,208	48,336,810
Interest, dividends, and real estate income due and accrued	8,113,695		8,113,695
Receivable from parent, subsidiaries, and affiliates	30,733,902		30,733,902
Write-ins for other than invested assets			
Miscellaneous other assets	62,843	37,515	25,328
Prepaid expenses	55,635	55,635	
Total Assets	$1,260,471,210	$21,725,032	$1,238,746,178

Progressive Northern Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 2002

Losses	$327,410,549	
Loss adjustment expenses	76,359,141	
Commissions payable, contingent commissions, and other similar charges	1,824,734	
Other expenses (excluding taxes, licenses, and fees)	28,378,274	
Taxes, licenses, and fees (excluding federal and foreign income taxes)	6,563,738	
Unearned premiums	356,881,596	
Advance premium	12,140,202	
Ceded reinsurance premiums payable (net of ceding commissions)	135,613	
Amounts withheld or retained by company for account of others	3,567	
Drafts outstanding	52,279,269	
Payable to parent, subsidiaries, and affiliates	9,021,374	
Write-ins for liabilities:		
State plan liability	3,415,010	
Other liabilities	399,121	
Escheatable property	295,205	
Unearned fee reserve	242,961	
2002 Private pass auto escrow	8,053	
Total Liabilities		$875,358,407
Common capital stock	3,008,000	
Gross paid in and contributed surplus	210,592,000	
Unassigned funds (surplus)	149,787,771	
Surplus as Regards Policyholders		363,387,771
Total Liabilities and Surplus		$1,238,746,178

Progressive Northern Insurance Company
Summary of Operations
For the Year 2002

Underwriting Income		
Premiums earned		$990,470,984
Deductions:		
Losses incurred	$568,515,569	
Loss expenses incurred	132,764,960	
Other underwriting expenses incurred	226,273,434	
Write-ins for underwriting deductions:		
2002 private pass auto escrow	62,263	
Total underwriting deductions		927,616,226
Net underwriting gain		62,854,758
Investment Income		
Net investment income earned	41,272,495	
Net realized capital (losses)	(27,028,622)	
Net investment gain or (loss)		14,243,873
Other Income		
Net (loss) from agents' or premium balances charged off	(10,760,000)	
Finance and service charges not included in premiums	27,221,049	
Write-ins for miscellaneous income:		
Service business revenue	842,830	
Interest income on intercompany balances	462,368	
Miscellaneous income	161,213	
Total other income		17,927,460
Net income before federal and foreign income taxes		95,026,091
Federal and foreign income taxes incurred		47,246,275
Net Income		$ 47,779,816

Progressive Northern Insurance Company
Cash Flow
As of December 31, 2002

Premiums collected net of reinsurance	$1,020,627,431		
Deduct:			
Loss and loss adjustment expenses paid (net of salvage or subrogation)	631,655,354		
Underwriting expenses paid	217,141,987		
Other underwriting expenses	62,263		
Cash from underwriting		$171,767,827	
Net investment income		45,233,958	
Other income (expenses):			
Agents' balances charged off	(10,413,402)		
Net amount withheld or retained for account of others	3,567		
Write-ins for miscellaneous items:			
Service charges not included in premiums	27,221,049		
Service business revenue	842,830		
Interest income on intercompany balances	462,368		
Miscellaneous income	161,213		
Total other income		18,277,625	
Deduct:			
Federal income taxes paid (recovered)		47,246,275	
Net cash from operations			$188,033,135
Proceeds from investments sold, matured, or repaid:			
Bonds	408,404,607		
Stocks	59,168,466		
Total investment proceeds		467,573,073	
Cost of investments acquired (long-term only):			
Bonds	665,037,549		
Stocks	28,859,277		
Real estate	126,026		
Total investments acquired		694,022,852	
Net cash from investments			(226,449,779)
Cash provided from financing and miscellaneous sources:			
Surplus notes, capital and surplus paid in	40,000,000		
Other cash provided	3,777,436		
Total		43,777,436	
Cash applied for financing and miscellaneous uses:			
Net transfers to affiliates	3,720,464		
Other applications	2,200,175		
Total		5,920,639	
Net cash from financing and miscellaneous sources			37,856,797

Net change in cash and short-term investments	(559,847)
Cash and short-term investments, December 31, 2001	1,122,568
Cash and short-term investments, December 31, 2002	$ 562,721

Progressive Northern Insurance Company
Compulsory and Security Surplus Calculation
December 31, 2002

Assets	$1,238,746,178	
Less security surplus of insurance subsidiaries	5,600,000	
Less liabilities	875,358,407	
Adjusted surplus		$357,787,771
Annual premium:		
Lines other than accident and health	1,051,442,636	
Factor	20%	
Compulsory surplus (subject to a minimum of $2 million)		210,288,527
Compulsory surplus excess (or deficit)		$147,499,244
Adjusted surplus (from above)		$357,787,771
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million, with a minimum factor of 110%)		231,317,380
Security surplus excess (or deficit)		$126,470,391

Progressive Northern Insurance Company
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	2002	2001	2000	1999	1998
Surplus, beginning of year	$288,570,131	$224,020,400	$234,589,063	$206,527,942	$213,954,364
Net income (loss)	47,779,816	48,335,617	(17,161,449)	26,135,516	42,006,065
Net unrealized capital gains or (losses)	(7,486,724)	(5,692,274)	26,596,553	(29,106,656)	(1,005,960)
Change in net deferred income tax	10,121,642	4,860,846			
Change in non-admitted assets	(13,511,436)	5,039,735	377,233	(871,739)	(2,744,527)
Change in provision for reinsurance	1,000	(1,000)			
Cumulative effect of changes in accounting principles		47,006,807			
Surplus adjustments:					
Paid in	40,000,000			32,000,000	
Dividends to stockholders		(35,000,000)	(20,000,000)		(46,000,000)
Write-ins for gains and (losses) in surplus:					
Prior year Federal Tax adjustments	(2,086,658)				
Change in excess statutory reserves over statement reserves			(381,000)	(96,000)	318,000
Surplus, end of year	$363,387,771	$288,570,131	$224,020,400	$234,589,063	$206,527,942

Progressive Northern Insurance Company
Insurance Regulatory Information System
For the Five-Year Period Ending December 31, 2002

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

	Ratio	2002	2001	2000	1999	1998
#1	Gross Premium to Surplus	652.0%	634.0%	704.0%	667.0%	637.0%
#2	Net Premium to Surplus	289.0	281.0	308.0*	293.0	288.0
#3	Change in Net Writings	30.0	17.0	1.0	16.0	4.0
#4	Surplus Aid to Surplus	0.0	0.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	88.0	93.0	96.0	88.0	84.0
#6	Investment Yield	5.1	5.6	4.9	4.8	6.0
#7	Change in Surplus	25.0	24.0	-6.0	14.0	2.0
#8	Liabilities to Liquid Assets	72.0	79.0	78.0	75.0	75.0
#9	Agents' Balances to Surplus	4.0	5.0	7.0	6.0	8.0
#10	One-Year Reserve Devel. to Surplus	1.0	-6.0	4.0	0.0	-9.0
#11	Two-Year Reserve Devel. to Surplus	-5.0	4.0	0.0	-10.0	-25.0
#12	Estimated Current Reserve Def. To Surplus	4.0	-7.0	-15.0	3.0	0.0

Ratio No.2 compares net premiums to surplus. This ratio is unusual due to the company's net premiums increasing at the same time that surplus decreased by $10,568,663 due in part to a $20,000,000 dividend to stockholders.

Growth of Progressive Northern Insurance Company

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
2002	$1,238,746,178	$875,358,407	$363,387,771	$47,779,816
2001	1,011,280,398	722,710,267	288,570,131	48,335,617
2000	895,018,741	670,998,341	224,020,400	(17,161,449)
1999	844,619,169	610,030,106	234,589,063	26,135,516
1998	720,704,663	514,176,721	206,527,942	42,006,065

Year	Gross Premium Written	Net Premium Written	Premium Earned	Loss And LAE Ratio	Expense Ratio	Combined Ratio
2002	$1,317,919,990	$1,051,442,636	$990,470,984	70.8%	19.8%	90.6%
2001	1,018,526,214	810,543,551	799,855,687	73.6	20.3	93.9
2000	886,282,244	690,906,338	709,289,909	83.6	19.6	103.2
1999	877,557,354	686,354,753	635,563,895	75.1	21.0	96.1
1998	721,255,552	594,106,535	548,909,185	68.4	20.8	89.2

Admitted assets, liabilities, gross premium written, net premium written, and premium earned increased during each year of the examination period. Surplus increased in each year with the exception of 2000 which coincides with the only year the company had a net loss. The company also paid a $20,000,000 dividend to stockholders in 2000. The company attributes the net loss in 2000 to the high loss ratio caused by inadequate rate levels, an increase in the loss severity trend and adverse loss development. The expense ratios are between 19.6% and 21.0% for the period under examination.

All of the company’s operations are conducted under agreements with its parent and other affiliates. Furthermore, the results of the company’s operations, other than investments, are pooled with certain of its affiliates. The experience of the company relative to net premiums, liabilities and net underwriting results follow the experience of the affiliated pool.

Reconciliation of Surplus per Examination

There were no adjustments or reclassifications to surplus as regards policyholders as determined by this examination.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were four specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Compulsory and Security Surplus—It is recommended that the company properly adjust the value of its investment in insurance subsidiaries on future filings of compulsory and security surplus calculations, pursuant to s. Ins 51.80, Wis. Adm. Code.

   Action—Noncompliance, further comment on this area can be found in the Summary of Current Examination Results section of this report.

2. Biographical Data—It is recommended that the company report biographical data relating to company officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

   Action—Compliance.

3. Drafts Outstanding—It is recommended that the company establish and maintain procedures for the timely and accurate reconciliation of drafts outstanding, including the identification of drafts that should be cancelled.

   Action—Noncompliance, further comment on this area can be found in the Summary of Current Examination Results section of this report.

4. Escheatable Property—It is recommended that the company comply with ch. 177, Wis. Stat., and the equivalent laws of other states in which it operates. It is further recommended that unclaimed funds be remitted to the company's state of domicile in those instances where the payee's state of domicile is unknown.

   Action—Noncompliance, further comment on this area can be found in the Summary of Current Examination Results section of this report.

Summary of Current Examination Results

IT Controls

The Progressive Corporation’s (TPC) contract with its IT vendor in section VI, paragraph C permits the IT vendor to deny access to the off-site data for non-payment disputes. In section VII, paragraph B of the contract, in the event of an IT vendor bankruptcy or other disruption of service, TPC cannot retrieve data for five days. While the probability of such occurrences is low, the effect on the group in the event of a disaster would be significant. Lack of access to back-up data for a period exceeding 72 hours would have severe economic consequences for TPC. It is recommended that the IT vendor contract be amended to permit The Progressive Corporation access to back-up data regardless of payment disputes. It is also recommended the IT vendor contract be amended to permit The Progressive Corporation access to back-up data regardless of the reasons for the disruption of service.

Compulsory and Security Surplus

Pursuant to s. 623.11, Wis. Stat., compulsory surplus is the amount of surplus “that an insurer is required to have in order not to be financially hazardous.” Investments in insurance subsidiaries may be counted toward satisfaction of compulsory surplus only to the extent that the value of a subsidiary exceeds the subsidiary’s security surplus requirement.

In preparing its compulsory and security surplus calculation as of December 31, 2002, PNIC did not consider the security surplus requirements of its two subsidiaries, Premier and Universal. The examination determined that the company’s calculation of surplus in excess of compulsory and security surplus requirements was overstated by $5,600,000. The examination’s calculation of surplus in excess of compulsory and security surplus requirements has been fully displayed in the “Financial Data” section of this report. It is again recommended that the company properly adjust the value of its investment in insurance subsidiaries on future filings of compulsory and security surplus calculations, pursuant to s. Ins 51.80, Wis. Adm. Code.

Bonds

The company listed securities on Schedule D of its annual statement with provisionally exempt (PE) designations for which the NAIC Securities Valuation Office (SVO) listed designations. The Company is to report these securities using the SVO designation and not list them as PE on the annual statement, in accordance with the Purposes and Procedures Manual of the NAIC Securities Valuation Office. It is recommended the company use the correct NAIC designation for securities presented in the annual statement consistent with the instructions of the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

Affiliated Balances

The company's use of its intercompany, reinsurance and cash accounts has led to a situation on a single entity basis that lacks a clear audit trail. The company is employing a single cash account, owned and controlled by PCIC, to collect and disburse its operating cash. Other members of the group are carrying intercompany balances due to/from PCIC in this account. Although the company was able to demonstrate that individual company receivable and payable balances were eventually cleared, the process was difficult to audit and raised several concerns on the adherence to statutory accounting principles. Among these concerns are the timeliness of settlements, settlements not involving cash, and only settling balances to within $100,000. The examination also could not determine if real estate was included in the settlement of affiliated balances. The company claimed it was not included in the calculation. It is recommended that the company develop, implement, and maintain a methodology to settle intercompany balances that provides a clear audit trail. It is also recommended that the company review and revise intercompany agreements as needed to reflect accurately the methodology and file the amended intercompany agreements for approval in compliance with s. Ins 40.04, Wis. Adm. Code.

Drafts Outstanding

The previous examination noted that the liability for outstanding drafts contained numerous entries that were in excess of five years old and other entries that did not appear to be offers of settlement. Many of these items were minor in amount and might have been the result of a duplicate payment. There was a recommendation from the previous examination that the company establish and maintain procedures for the timely and accurate reconciliation of drafts outstanding and that the account be cleared of all aged items that were not offers to settle. The current examination found the account in a similar condition as the last examination. It is again recommended that the company establish and maintain procedures for the timely and accurate reconciliation of drafts outstanding, including the identification of drafts that should be cancelled.

Escheatable Items

Chapter 177, Wis. Stat., also known as the Uniform Unclaimed Property Act, provides that certain forms of abandoned property be forwarded to the custody of the state. The prior examination found that the company generally does not escheat claim drafts as abandoned property to the unclaimed property funds of the states in which it does business. The company's position is that such drafts represent offers to settle, and that such drafts are unliquidated obligations that are not payable or disbursable unless and until they are accepted and presented for payment.

The examiners agree that checks and drafts are different types of instruments, which is the basis of their distinct presentation in the annual statement. A draft for which the amount is in the course of adjudication in good faith or in dispute before the courts need not be regarded as an escheatable item.

However, s. 177.02, Wis. Stat., provides that:

"(1) Except as otherwise provided in this chapter, all intangible property, including any income or increment derived from it, less any lawful charges, that is held, issued or owing in the ordinary course of a holder's business and that has remained unclaimed by the owner for more than 5 years after it became payable or distributable is presumed abandoned. (2) Property is payable or distributable for the purpose of this chapter notwithstanding the owner's failure to make demand or to present any instrument or document required to receive payment."

There are a variety of reasons why a claimant may fail to present a draft for payment that would have nothing to do with an intention to decline the settlement offered by the company. Each cancelled draft should be traceable to a claim file and such claim file should properly document the reasons for which a claim is closed without payment.

It is again recommended that the company comply with ch. 177, Wis. Stat., and the equivalent laws of other states in which it operates. It is again recommended that unclaimed funds be remitted to the company's state of domicile in those instances where the payee's state of domicile is unknown.

Reinsurance Recoverable

The reinsurance recoverable on paid losses and paid loss adjustment expenses are not being recorded on Schedule F of the annual statement for the pooled companies. The company does not report the paid loss and loss adjustment expenses on Schedule F because it takes the position that since the paid reinsurance is settled prior to reporting through an inter-company reclassification of the paid losses, the paid loss and loss adjustment expenses need not be reported in Schedule F. According to SSAP No. 63 Par. 8, all reinsurance transactions shall be recorded as direct, assumed, and/or ceded, as applicable. "To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement."

The examiners have taken the position that the reclassification of a reinsurance recoverable and payable to an inter-company account does not constitute settlement, since there is no consideration exchanged. The reinsurance recoverables on paid losses and ceded balances payable should be recorded on the annual statement as such instead of netted into an inter-company receivable or payable. It is recommended that the company properly report paid losses and loss adjustment expenses and ceded premiums payable in the annual statement in accordance with SSAP No. 63 Par. 8.

Claims Office Records Retention

It was determined that the claim offices were not following record retention requirements. Both accuracy testing, which compares the company's claim system to hardcopy claim files, and completeness testing, which confirms that all drafts issued related to a sample of claims were properly recorded on the company's system, were performed. It was discovered that the hardcopy claim files did not contain copies of all of the drafts that appeared on the company's system. The results of the testing found that 71 drafts or 17.8% of the sample of files for accuracy testing revealed lost drafts and 95 drafts or 14% of the sample of files for completeness testing results revealed lost drafts. Based on these findings the record retention requirements need improvement. It is recommended that the company implement necessary steps at the claim offices to improve record retention and to adhere to company established policies and procedures related to record retention and s. Ins 6.80, Wis. Adm. Code.

Subsequent Events

Premier and Universal were wholly owned subsidiaries of PNIC as of December 31, 2002. Effective August 29, 2003, PNIC transferred ownership of these two subsidiaries to TPC through a dividend.

PNIC and Classic were wholly owned subsidiaries of TPC as of December 31, 2002. Effective January 1, 2004, all of the outstanding capital stock of PNIC and Classic was transferred from TPC to Progressive Agency Holdings, Inc., a wholly owned subsidiary of TPC. Progressive Agency Holdings, Inc., was incorporated on September 22, 2003. This transaction was filed with the Office of the Commissioner of Insurance on October 2, 2003, and subsequently approved pursuant to s. 611.72 (2), Wis. Stat.

VIII. CONCLUSION

There were no adjustments or reclassification to surplus as regards policyholders as determined by this examination. The company complied with one of the four prior examination recommendations. The recommendations on proper reporting of compulsory and security surplus, timely and accurate reconciling of drafts outstanding and proper reporting of escheatable items have been repeated. This examination also made recommendations on amending the contract with the group's off-site IT vendor to allow access regardless of payment disputes, proper reporting of bond designations, revising cash management methods, proper reporting of reinsurance recoverables, and implementing record retention policies for its claims offices.

Admitted assets, liabilities, gross premium written, net premium written, and premium earned increased each year under examination. Surplus increased in each year under examination with the exception of 2000 which coincides with the only year the company had a net loss. The company also paid a $20,000,000 dividend to stockholders in 2000. The company attributes the net loss in 2000 to the high loss ratio caused by inadequate rate levels, an increase in the loss severity trend and adverse loss development. The expense ratios are between 19.6% and 21.0% for the period under examination.

Effective August 29, 2003, PNIC transferred ownership of its wholly owned subsidiaries, Premier and Universal, to The Progressive Corporation through a dividend. Also, effective January 1, 2004, all of the outstanding capital stock of PNIC and Classic has been transferred from The Progressive Corporation to Progressive Agency Holdings, Inc., a wholly owned subsidiary of The Progressive Corporation.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 27 - IT Controls—It is recommended that the IT vendor contract be amended to permit The Progressive Corporation access to back-up data regardless of payment disputes. It is also recommended the IT vendor contract be amended to permit The Progressive Corporation access to back-up data regardless of the reasons for the disruption of service.

2. Page 27 - Compulsory and Security Surplus—It is again recommended that the company properly adjust the value of its investment in insurance subsidiaries on future filings of compulsory and security surplus calculations, pursuant to s. Ins 51.80, Wis. Adm. Code.

3. Page 28 - Bonds—It is recommended the company use the correct NAIC designation for securities presented in the annual statement consistent with the instructions of the Purposes and Procedures Manual of the NAIC Securities Valuation Office.

4. Page 28 - Affiliated Balances—It is recommended that the company develop, implement, and maintain a methodology to settle intercompany balances that provides a clear audit trail. It is also recommended that the company review and revise intercompany agreements as needed to reflect accurately the methodology and file the amended intercompany agreements for approval in compliance with s. Ins 40.04, Wis. Adm. Code.

5. Page 29 - Drafts Outstanding—It is again recommended that the company establish and maintain procedures for the timely and accurate reconciliation of drafts outstanding, including the identification of drafts that should be cancelled.

6. Page 30 - Escheatable Items—It is again recommended that the company comply with ch. 177, Wis. Stat., and the equivalent laws of other states in which it operates. It is again recommended that unclaimed funds be remitted to the company's state of domicile in those instances where the payee's state of domicile is unknown.

7. Page 30 - Reinsurance Recoverable—It is recommended that the company properly report paid losses and loss adjustment expenses and ceded premiums payable in the annual statement in accordance with SSAP No. 63 Par. 8.

8. Page 31 - Claims Office Records Retention—It is recommended that the company implement necessary steps at the claim offices to improve record retention and to adhere to company established policies and procedures related to record retention and s. Ins 6.80, Wis. Adm. Code.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
David A Grinnell	Insurance Financial Examiner

Respectfully submitted,

Kerri Lee Miller
Examiner-in-Charge